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In the Supreme Court of the United States

OCTOBER TERM, 1984

COMMUNICATIONS SATELLITE CORPORATION, APPELLANT

v.

FRANCHISE TAX BOARD

ON APPEAL FROM THE CALIFORNIA COURT OF APPEAL FOR THE FIRST APPELLATE DISTRICT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

California apportions the net income of a multistate corporation by means of the standard three-factor apportionment formula, based on the ratio of the corporation's in-state property, payroll, and sales to its worldwide property, payroll, and sales. The question presented is whether California, in apportioning appellant's communications satellite income, may, consistently with the Commerce and Due Process Clauses, treat as in-state property, satellites permanently located in outer space, and treat as in-state sales, revenue derived by appellant from those satellites and from its interest in the global system of satellites and ground control facilities located in other States, in foreign nations, and in outer space.

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INTEREST OF THE UNITED STATES

In 1962 Congress declared "that it is the policy of the United States to establish, in conjunction and in cooperation with other countries, as expeditiously as practicable a commercial communications satellite system, as part of an improved global communications network." Communications Satellite Act of 1962, Pub. L. No. 87-624, § 102(a), 76 Stat. 419 (presently codified at 47 U.S.C. 701(a)). Congress intended that this system would "be responsive to public needs and national objectives," would "serve the communications needs of the United States and other countries," and would "contribute to world peace and understanding" (*ibid.*).

Congress chose to implement this policy by creating a private corporation — the Communications Satellite Corporation, popularly known as Comsat. Comsat was established under federal law and is subject to federal regulation

and supervision (47 U.S.C. 701(c), 721, 731, 741). The President is responsible for planning, developing and fostering a national program for a commercial communications satellite system (47 U.S.C. 721(a)(1)). The President supervises Comsat's relations with foreign governments and appoints, with the advice and consent of the Senate, three members of Comsat's board of directors (47 U.S.C. 721(a)(4), 733).

Comsat represents the United States in the International Telecommunications Satellite Consortium (Intelsat), whose function is to relay telecommunications between nations. Intelsat was established as an international joint venture in 1964 by intergovernmental agreement (Agreement Establishing Interim Arrangements for a Global Commercial Communications Satellite System, Aug. 20, 1964, 15 U.S.T., Pt. 2, at 1705). Intelsat operates the "space segment" — the satellites and related tracking facilities — of the global satellite system. Since Intelsat's founding, Comsat has acted as manager of all Intelsat's facilities in the "space segment" (J.S. App. A3-A4).

On July 20, 1984, the White House announced the President's National Policy on the Commercial Use of Space. That policy seeks to promote private sector investment and involvement as essential steps in developing the commercial potential of outer space, and envisions industrial research and manufacturing in space, as well as development of space-based services, on a large scale. Among the primary goals of the President's policy is the elimination of tax laws and regulations that burden or discriminate against commercial space ventures.

The United States has a strong interest in the manner in which its states tax the federally-established corporation through which part of this Nation's space policy is pursued.

California's effort to sweep extraterrestrial values into its tax base, moreover, raises serious questions about the states' power to assert jurisdiction in outer space, a realm of paramount federal concern. The decision below could presage attempts by the States to tax (or otherwise to assert jurisdiction over) other activities that may be conducted in outer space, such as manufacturing or research aboard the Space Shuttle and eventually aboard the Space Station. The decision below thus threatens to inhibit the federal government's policy of removing obstacles to successful commercial development in outer space.

STATEMENT

1. The facts, which were stipulated, are set forth in the jurisdictional statement (J.S. 2-10) and in the decision below (J.S. App. A2-A25), and are briefly summarized here. The Intelsat system, of which Comsat is a member, has two parts. The first part is the "space segment," which consists of communications satellites in orbit and four terrestrial tracking stations (located in Maine, Hawaii, Italy, and Australia) from which the satellites are monitored and controlled. The space segment assets operated by Intelsat are owned in undivided shares by its members, including Comsat, in varying percentages. During 1970-1972, Comsat's ownership interest in those assets was about 52.5% (J.S. App. A4).

The second part of the Intelsat system is the "ground segment," which consists of earth stations in various countries owned by entities (including Comsat) in those nations. An earth station is a facility with large antennae and supporting electronic equipment. Comsat has an interest in eight United States earth stations that are part of Intelsat's ground segment (J.S. App. A5). One of Comsat's earth stations is located in California (*ibid.*).

Comsat is a corporation organized under federal law and the District of Columbia Business Corporation Act, and has its principal place of business in Washington, D.C. (J.S. App. A2). Comsat earns most of its revenue from leasing, to various communications common carriers, "half-circuits" between its eight earth stations and the Intelsat satellites.[1] Comsat's California earth station, like its seven other earth stations, is used solely in interstate and foreign commerce. In essence, the earth station receives a communication signal, destined for an offshore point or foreign country, from somewhere within the United States through telephone lines or microwave relay systems owned and operated by communications common carriers other than Comsat. The earth station transmits the signal up to an Intelsat satellite, which in turn continues the transmission down to a foreign earth station and thence to the ultimate destination. Conversely, Comsat's California earth station receives, from an Intelsat satellite, communications coming from abroad for transmission (again through communications common carriers other than Comsat) to destination points in the United States (J.S. App. A4-A6). The revenue Comsat receives from leasing half-circuits thus reflects charges for the use of both the "earth-station end" and the "satellite end" of the half-circuit in question.

The balance of Comsat's revenue represents its share of income derived by Intelsat from user fees paid by Intelsat's members — including fees paid by Comsat itself — for use of Intelsat's "space segment" facilities. As noted above, those facilities (both the satellites and the four terrestrial tracking stations) are located entirely outside California.

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[1] A half-circuit is a two-way communications channel between an earth station and a satellite. The connecting half-circuit between the satellite and another earth station completes the circuit and permits the international communication to take place (J.S. App. A5).

Intelsat has no employees or property in California and derives its revenue exclusively from these user fees (J.S. App. A6-A7; Stip. ¶ 12).

2. Because it does business both within and without the State of California, Comsat is required, for California tax purposes, to determine how much of its income is derived from that State. California has substantially adopted the Uniform Division of Income for Tax Purposes Act (UDITPA), which provides a familiar three-factor formula, based on property, payroll and sales, for apportionment of a multistate taxpayer's income. Under that formula, the numerator of the property fraction is "the average value of the taxpayer's real and tangible personal property owned or rented and used in [California] during the income year" (Cal. Rev. & Tax. Code § 25129 (West 1979)). The numerator of the sales fraction is "the total sales of the taxpayer in [California] during the income year" (*id.* § 25134). A regulation provides that gross receipts from leasing tangible personal property are includible in the sales factor numerator only to the extent that the leased property "was physically present or was used in" California during the income year (Cal. Franchise Tax Bd. Reg. 25136(B) (1971). The denominators of the property and sales fractions are the taxpayer's worldwide real and tangible personal property, and its worldwide sales, respectively.

The controversy here arose from Comsat's computation of its property and sales fractions for California tax purposes. In computing the numerator of its property fraction, Comsat included all of its real and tangible personal property located in California — viz., the value of its interest in the California earth station and the value of its small engineering office in Los Angeles County (J.S. App. A12). Comsat did not include in the numerator any portion of the value of its interest in the Intelsat satellites, because those

satellites are located, not in California, but in outer space. The satellites are launched from Cape Canaveral, Florida, and are permanently located in synchronous orbit 22,300 miles over fixed points on the Equator. The satellites never pass over California, even during launch, and their orbital position is never over California (Stip. ¶¶ 8-9).

Similarly, in computing the numerator of its sales fraction, Comsat included that portion of its rental income attributable to use of the "California earth-station end" of the leased half-circuits. Comsat did not include the portion of its rental income attributable to use of the "satellite end" of the leased half-circuits, nor did it include its share of the revenue Intelsat derived from leasing "space segment" facilities to Intelsat members worldwide (J.S. App. A13-A15). As noted above, Intelsat has no activities in California, and none of its "space segment" facilities (satellites and terrestrial tracking stations) are physically present or used in California.

3. The California Franchise Tax Board asserted that the statutory three-factor formula did not accurately reflect Comsat's California-source income because it excluded the revenue Comsat derived from its interest in the satellites in outer space. Accordingly, the Board applied a special ad hoc formula to include part the value of the Intelsat satellites in the numerator of Comsat's property fraction, and to include part of the revenue Comsat derived (either directly or through Intelsat) from these satellites and their associated tracking stations in the numerator of Comsat's sales fraction. The result of those adjustments for the tax years at issue (1970-1972) was to increase Comsat's California property fraction from about 2.5% to 5%, and to increase its California sales fraction from about 3.7% to 16.5% (J.S. App. A20 n.10). The effect was to raise Comsat's California tax liability by more than $310,000 for those years (*id.* at A44).

4. The Superior Court for the City and County of San Francisco rejected the Board's determination (J.S. App. A38-A45). It concluded that the Board's attempt to include, in Comsat's property and sales factor numerators, property and revenue from property not located within California, was impermissible under the California Revenue and Taxation Code. The Superior Court thus had no need to address Comsat's constitutional arguments.

The Court of Appeal for the First Appellate District reversed (J.S. App. A1-A37). It specifically rejected (*id.* at A35-A37) Comsat's arguments that California's proposed method of taxation violated the Commerce Clause and the Due Process and Equal Protection Clauses of the Fourteenth Amendment. The court reasoned that there was "an invisible, but apparently continuous and very real, connection between the [California] earth station and the satellites" (*id.* at A28). Because of this "invisible connection," the court concluded, the satellites effectively "function in California," with the result that they should be deemed "tangible personal property owned * * * and used in" California for purposes of the property-factor numerator (*id.* at A28-A29). Similarly, because the satellites assertedly "function at the California earth station" (*id.* at A32-A33) by virtue of the "invisible connection," the court concluded that "their 'income-producing activity' is also 'performed in this state' " (*id.* at A33). The court accordingly held that the revenues Comsat derives from the satellites, and the revenues Comsat derives indirectly through Intelsat from the satellites and their associated tracking stations,[2] should

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[2] The court of appeal apparently believed (see J.S. App. A20) that Intelsat's revenue comes only from the satellites themselves. As noted above, however, Intelsat's revenue derives from user fees paid by its members for use of Intelsat's "space segment" facilities. The "space segment" includes, not only the satellites, but also the four terrestrial tracking stations located in Maine, Italy, Australia and Hawaii (J.S. App. A4; Stip. ¶ 12).

be deemed "sales in [California]" for purposes of the sales-factor numerator (*ibid.*).

For these reasons, the court of appeal upheld the Board's determination of Comsat's tax liability (J.S. App. A37). The California Supreme Court denied Comsat's petition for a hearing (*id.* at A51). Comsat properly invokes this Court's appellate jurisdiction under 28 U.S.C. 1257(2).

DISCUSSION

This case presents a substantial federal question concerning the jurisdiction of a state to tax income derived from satellites located in outer space and from communications satellite facilities located in other states and foreign nations. We believe that the decision below is wrong as a matter of federal constitutional law and that it poses a potentially serious threat to federal policy in a realm of obvious federal concern. This Court should note probable jurisdiction and reverse the judgment below.

It is of course unquestioned that a State may tax, on a fairly apportioned basis, income generated by the interstate and foreign activities of a unitary business. There must, however, be "a rational relationship between the income attributed to the State and the intrastate values of the enterprise" (*Container Corp. of America* v. *Franchise Tax Board*, No. 81-523 (June 27, 1983), slip op. 4 (original quotation marks omitted)). "[A] state may not, when imposing an income-based tax, tax value earned outside its borders" (*id.* at 2 (original quotation marks omitted)). See *ASARCO, Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982); *Exxon Corp.* v. *Department of Revenue*, 447 U.S. 207, 219-220 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 437 (1980); *Connecticut General Life Ins. Co.* v. *Johnson*, 303 U.S. 77, 80-81 (1938). These principles inform analysis under both the Due

Process and the Commerce Clauses (see *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977)), and have if anything even greater force where (as here) foreign commerce is involved. See *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 446-451 (1979).

The court below held that Comsat's interest in the satellites and in Intelsat's other "space segment" property were within California's taxing jurisdiction because of an "invisible connection" between the satellites and Comsat's earth station in California. This reasoning is seriously flawed. The relationship between the earth station and the satellites, obviously, does indicate that they are part of a "unitary business" carried on by Comsat. Thus, California may include Comsat's satellite income in the *apportionable tax base* to which a properly-devised apportionment formula may be applied. The " invisible connection " between the earth station and the satellites, however, plainly does not entitle California to reel in and include *in Comsat's apportionment fraction numerators* property located in, and revenue derived from, foreign nations and outer space. Under the Due Process Clause, the numerators of the apportionment fraction must reflect in-state values. The only "in-state" values Comsat has in California are a single earth station and a small engineering office. The satellites are located in outer space, and Intelsat's other "space segment" facilities are located in Maine, Hawaii, Italy, and Australia.

The error of the court below appears with particular clarity if one considers the logical impact of its theory on the domestic end of the international telecommunications link. There is obviously a connection (be it visible or invisible) between Comsat's California earth station and the telephone or microwave equipment (located, say, in Idaho) used to transmit a domestic signal to or from that station for ultimate transmission to or from the satellite. But it could

scarcely be contended that this "connection" would permit California to include that Idaho equipment or the revenue it generated (assuming Comsat owned it) in the numerators of Comsat's California apportionment fraction. And the fact that the connection between the earth station and the satellites is "invisible" makes no difference for purposes of the Due Process Clause. A wire connection with telephone switching equipment in Colorado would not justify treating that equipment as California property, and a rail connection with railroad stations in Missouri would not justify treating revenue from those stations as California sales. "Invisibility" is not a constitutional litmus test.

The court below concluded that California's tax was constitutionally permissible on the theory that it did not "discriminate" against interstate or foreign commerce (J.S. App. A36). We question that conclusion. California, after all, has abandoned its statutory apportionment regime and its own interpretative regulations in this case and has devised an ad hoc formula uniquely designed to increase the tax liability of Comsat, a corporation operating exclusively in interstate and foreign commerce and the only corporation to which that ad hoc formula has been applied. But even if the court of appeal's conclusion as to nondiscrimination were correct, it obviously would not save California's tax as applied here. In order to pass muster under the Commerce Clause — and a fortiori under the Due Process Clause — a state tax not only must "not discriminate against interstate commerce," but also must be "fairly apportioned" and be "fairly related to the services provided by the State" (*Complete Auto Transit, Inc.*, 430 U.S. at 279). Because California has computed Comsat's tax by including out-of-state values in the numerators of its property and sales fractions, the tax fails both of these latter tests.

CONCLUSION

The Court should note probable jurisdiction.

Respectfully submitted.

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